

An Update on the Economies of Guam and Commonwealth of the Northern Mariana Islands (CNMI)

By

Wali M. Osman, Ph.D.
Regional Economist

May 2004

I. Introduction

Following several years of stagnation and decline, Guam's economy is headed for recovery and growth. The levels of activity in the two main engines of growth, tourism and national defense, are rising, although for different reasons and with different effects on Guam's economy, the labor market and public finances.

While benefiting hotels, restaurants, shopping malls and other facilities catering mainly to tourists, increases in tourist traffic without discernible increases in the average tourist spending tend to have subtle and gradual effects on the economy, government finances and the labor market. With Guam's hotel occupancy rates averaging in the 50-60 percent range during most of the last 3-4 years, currently projected increases in tourist traffic are a long way from bringing financial strength to local hotels and making a visible impact on the rest of the economy. At such an early stage of recovery and expansion, gains in tourist traffic have to be registered for several months to be considered a turning point from the current stage of the business cycle.

By contrast, increases in defense spending, especially in force and personnel, refurbishment of base facilities and new construction projects tend to have a more perceptible effect, as some of these create immediate work opportunities. Now that both tourism and defense outlays are rising simultaneously, the prospect for recovery in Guam's economy is better than in several years. It is too early to suggest the depth and breadth of this recovery, but if both tourism and defense spending rise consistently for 4-6 months, it will be possible to make a more quantitative assessment of gains in business, the tax base, public finances, employment and, eventually, total output.

I.1 Recovery in Tourism

Recovery in tourist traffic is fueled by what still appears to be weak but consistent signs of economic growth in Japan. Having suffered from one of the longest periods of decline and stagnation, the Japanese economy began to show signs of regaining some momentum in early 2003. The 1.5-2.0 percent growth rate the Japanese economy has registered since early last year is much lower than its own record during the years preceding the 1990s decline and what the economy needs to make a broader regional impact. However, the fact that the Japanese economy is no longer declining is in itself an important signal of better times ahead and travel abroad. Adding to the momentum in the Japanese economic recovery is the prospect of a stronger world economy, especially in

China and the rest of Japan's neighborhood and across the Pacific in the United States with which Japan has significant economic and financial ties.

In addition to economic and financial recovery returning to Japan, safety and stability in global air traffic in the post-September 11, 2001, world has also been an important factor, especially for Japanese travelers who are among the most cautious tourists. Air traffic safety, in conjunction with an improving economy, has encouraged many Japanese to travel abroad again. Japan's travel industry expects the number of outbound Japanese travelers this year to rebound toward the 17-19 million level, considered normal for Japan. Japan's outbound travel in the last few years dropped to the 14-15 million mark.

Among tourist destinations in Japan's neighborhood that benefit directly and immediately from a Japanese economic recovery is Guam. Guam's principal advantages are proximity, Guam's "America in Asia" cultural attributes and reasonably good facilities. When the Japanese economy returns to normal patterns of growth, Japanese tourists returning to levels considered normal for Guam would be only a matter of time.

In 2003, Guam received 909,506 tourists. Not only was this number 14.1 percent below the previous year, this was the first time in a decade that Guam had fewer than one million tourists. Tourist arrivals to Guam peaked at 1.382 million in 1997, the onset of the Asian financial crisis, and dropped 17.1 percent in 1998. A modest recovery followed in 1999-2000, when it was derailed by the aftermath of terrorist attacks on New York and Washington in September 11, 2001. In 2002-2003, air traffic concerns, the weak Japanese economy, severe typhoons and the SARS epidemic all combined to keep Japanese tourists away from many destinations. Since Guam did not play a direct role in the post-September 11 military buildup related to the war on terror, it did not benefit directly from spending emanating from the war.

In 2004, most of the economic, financial and security factors affecting Guam's tourism are moving in directions favorable to the American territory's economy. Defense spending on Guam has more to do with refurbishing facilities damaged by typhoons and aging, rather than moves related either to the war on terror or new defense initiatives in Asia. Increases in force and personnel have thus far been limited to a small submarine task force unrelated to the war on terror. Still, the trend of rising defense outlays on the island certainly adds more momentum to economic and financial recovery than tourism because of its higher multiplier effect, as more of defense dollars tend to stay in the local economy. Anecdotal evidence on defense spending increases provided by bits and pieces such as contracts put out for bid or awarded reported in the local media is much more favorable to Guam than has been the case in the last few years.

Changes in tourist traffic and its impact are, on the other hand, more readily quantifiable because of more current and complete data on tourist arrivals and spending which the Guam Visitors Bureau routinely maintains. In January, tourist arrivals increased 76 percent to 101,515 from 57,826 in January of 2003. The percent change is large, but that, in fact, is merely recovery to a level considered normal for Guam. With over one million tourists a year every year in 1994-2002, the average monthly figure, with adjustments for seasonal variations common to tourist traffic, was around 100,000. In 2003, Guam did not receive 100,000 tourists in any month.

With tourist traffic in the first month of 2004 returning to what may be considered normal, the expectation is that Guam will have, once again, one million tourists this year.

If that happens, it will mean not only some level of recovery in tourism and the economy but regaining confidence that Guam is indeed a major regional destination that has experienced substantial but mainly cyclical changes that now appear to be past. Also, higher levels of tourist traffic and subsequent increases in hotel and other taxes would contribute to improving the financial condition of the territory. A 50 percent increase in the local gross receipt tax (GRT) from 4.0 to 6.0 percent, implemented in April 2003 because of a financial emergency, was repealed this March. The main reason for approval of the repeal by Guam's Legislature and the Governor was the expected increase in local revenues, emanating from both tourism and national defense gains.

I.2 Financial Recovery

The territory's overall financial health is another story. As of January this year, the Government of Guam (GovGuam) was still paying individual tax refunds for tax years 2000 and 2001, and some GovGuam agencies were still in arrears in rent and vendor payments. GovGuam still has other formidable financial obstacles to overcome. Among them is a large operating debt for which GovGuam wanted to issue new bonds; the case is in the courts of law, rather than in financial markets. Guam's attorney general challenged GovGuam's prerogative to issue bonds based on assessed value of property to retire existing operational debt. The Ninth Circuit Court of Appeals in San Francisco is to decide whether GovGuam is within its legal authority to issue such bonds.

Given information gaps that have not yet been remedied, it may be some time before a more objective assessment of Guam's economic performance is available. However, the signs so far this year indicate a path to recovery. With its aging tourist infrastructure and extensive damage caused by a series of destructive typhoons in the last few years, the American territory's impending economic recovery may once again attract foreign capital and skills to launch the next stage of business and economic recovery.

II. CNMI

Unlike Guam's economic growth engines which are gaining momentum at the same time, CNMI's tourism and garment-making are on two different tracks. Much of what can be said for Guam in the context of tourism applies to CNMI as well since its main tourist market is also Japan. The CNMI tourism industry expects a 20-percent increase in total tourist traffic this year, which would raise total arrivals to about 570,000. While better than 2003's total, even that level of tourists would be far short of the 736,000 CNMI received in 1996. Just as in the case of Guam, recovery to the previous peak may be some time away, but the improving Japanese economy will make it possible to move in that direction. Since CNMI's financial condition has been much less tenuous than Guam's, remedies needed to restore financial health and a more tenable debt situation would also be easier to obtain.

The garment industry on Saipan faces different challenges. As January 2005 nears, Saipan garment-makers would be expected to search for other markets where production costs may be lower. However, it is unlikely that Saipan garment-makers would move abroad at once, even under the most difficult conditions. The most likely scenario for Saipan's garments is that they will continue to produce at current levels

(around \$800-900 million of gross sales) during 2004. If that is to be the case, CNMI's economy will do better this year than in the last 2-3 years.

Beyond the uncertainty surrounding garment-making, a somewhat longer-term prospect for CNMI looks more promising, mainly because of the emergence of China as a regional tourist supplier. Outbound tourist traffic from China is expected to increase substantially in the years ahead, and CNMI's advantage is in the presence of tourist facilities already on the ground that cater to Chinese tourists. Also, since CNMI-bound tourists do not need U.S. visas, as they do to enter Guam, CNMI has the advantage to receive Chinese tourists any time once China places the Commonwealth on the list of "approved destinations" and allows Chinese citizens to travel there. The hotel and casino on Tinian, although struggling to stay open since they started business in 1996, have the capacity to receive and entertain large numbers of Chinese tourists. In fact, there is already a plan for expansion should circumstances call for an increase in capacity.

The fact that the Tinian facilities are owned and operated by Chinese interests from Hong Kong is a plus for the operators. They know the Chinese gambling market and how to attract tourists from that market to CNMI which is a relatively short flight from either Hong Kong or Guangzhou (Canton), the main city in southern China. With Chinese tourists increasing in the years ahead, simply because per capita income is rising at the rate that occurred in Japan in the 1950s and 1960s and Korea during the 1970s and 1980s, CNMI has both the facilities and the cultural and linguistic advantages to receive Chinese tourists. It may be some time before Tinian becomes a mini-Macao, but it certainly has the potential.

The main comparative advantage CNMI has as a tourist destination is that it has more than one island, and each has its own attributes and comparative strengths. Rota is a preserved area and it may remain that way in the foreseeable future. Still, one of Rota's most valuable uses may be as a meeting facility for world and regional leaders when the island has facilities for such a purpose. Tinian's infrastructure is currently geared mainly toward Chinese tourists, possibly Korean tourists as well, especially gamblers. Other tourists and local residents are just as welcome to the casino and hotel as anyone else. With the mix of tourists and tourist facilities it has, CNMI is in an advantageous position to benefit from economic recovery in Japan and increased outbound travel from China.